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TO: The Board of Directors and Management of Missouri state-chartered credit unions

SUBJECT: Courtesy Pay Programs

Since the issuance of BULLETIN NO 2003-CU-03 Courtesy Pay Programs, additional information about these programs from several sources has become available. Among the sources consulted, we acknowledge permission from the Washington State Department of Financial Institutions to utilize information from their Bulletin. **BULLETIN NO 2003-CU-03 is now replaced with BULLETIN NO 2004-CU-02.**

A number of Missouri chartered credit unions are offering courtesy pay privileges to their members. While these programs are a service to members, credit unions should conduct themselves in the best interest of their members by considering the following guidance and best practices. The Division of Credit Unions (the Division) encourages credit unions to inform members of the risks and consequences of relying on these products, and the costs and benefits of various alternatives for short-term customer borrowing (e.g., transferring from savings, lines-of-credit, and credit cards).

Guidance provides what the Division views as features of an Overdraft Protection Program that are safe and sound, and provide adequate member protection. While Guidance does not have the force of law, it expresses the Division's view of what credit unions should strive to achieve.

A Best Practice is an example that addresses certain issues of an Overdraft Protection Program. A Best Practices may exceed the features as set forth in the Guidance.

Please direct any questions about the Guidance and the Best Practices to Division of Credit Unions at 573-751-3419 or by e-mail at cu@ded.mo.gov.

Courtesy Pay Programs

Advertising & Marketing

Guidance

- No Misleading Advertising or Marketing. If you market these programs your advertising should not be misleading to the reasonable member. This can be accomplished by adhering to the following general Guidance.
- Key Elements of the Program Should Be Clear. Advertising and marketing should contain key elements of the Program and should be designed to allow the member to understand his/her options. Such materials should not be inconsistent with terms provided in disclosure documents.
- Discretionary Service. Advertising and marketing should be clear that payment of the overdraft is a discretionary service and not automatic.

- Refrain from Misleading “Overselling”. Advertising and marketing should refrain from statements that oversell the benefits of Overdraft Protection and give the wrong impression about the scope of its protection. Statements such as the following should be avoided:
 - “No more charges from retailers for insufficient checks.”
 - “Make a mistake -- you’re covered.”
 - “Write a check or use an ATM for more than you have in the credit union -- you’re covered.”
 - “Money may not grow on trees, but here’s the next best thing.”

Best Practices

- Promotes the Overdraft Protection Program as being available when members share draft accounts are accidentally overdrawn.
- States clearly that any current overdraft arrangements will remain in place, with the Overdraft Protection Program only being activated if there are insufficient funds available from all other arranged accounts.
- States clearly the overdraft limit and associated overdraft fee.
- Sets a clear expectation for repayment within 30 days or collection processes begin.
- Provides an opt-out notice.

“Automatic” Eligibility

Guidance

- Notify When “Automatically” Added to Account. A member should not first learn about the Overdraft Protection Program when the first overdraft notification letter is received. The credit union should promptly notify the member and provide full disclosure of the Program when the account is opened or when the member meets the “automatic eligibility” requirements.

Internal Decision-Making Policies

Guidance

- Consistent Eligibility Requirements. Eligibility requirements should be consistently applied. The member should be informed of eligibility requirements at account opening.
- Fair Lending Concerns. Even though Overdraft Protection may be exempt from the Truth-in-Lending Act (TILA), this “discretionary service” may nonetheless constitute “credit” within the meaning of the Equal Credit Opportunity Act (ECOA), at 15 USC, section 1691a. Moreover, if credit scoring for eligibility purposes is applied in a manner that would result in a discriminatory “effect,” a credit union may face potential liability for such credit scoring, however well intentioned it may be. Although there is nothing discriminatory about credit scoring per se, we caution credit unions to be watchful of their internal eligibility procedures -- particularly because intent to discriminate is not a requisite of a “fair lending” claim.

Notification & Terms of Overdraft Protection

Guidance

All credit unions can improve upon their disclosures, both as to clarity and/or specificity of all terms. This is true of brochures, deposit contracts and other disclosures.

- Complete Disclosure. There should be complete disclosure of all terms of Overdraft Protection at account set up or when the member meets “automatic eligibility” requirements. Disclosures should be clear, concise, easy to read, and include the following elements:
 - How the program may be used.
 - Any restrictions imposed by the credit union.
 - Eligibility.
 - Notice.
 - Overdraft limits.
 - Repayment.
 - Costs/Fees.
 - The discretionary nature of the credit union’s decision to honor an overdraft.
 - Method to contact the credit union if the member has questions.
 - Rights and methods to opt-out.
- Avoid misleading members About Overdraft Limits. A credit union should not mislead members about the extent of overdraft limits.

Best Practices

- Repeatedly and clearly emphasizes the service is “discretionary” and not “automatic.”
- Reminds the member of his/her responsibility to record all balances and transactions (including check card purchases, ATM withdrawals, electronic bill payments or other automatic transactions) and to maintain sufficient funds within his/her account.
- Provides a member service hotline for additional information or to have the brochure explained by a member service representative.
- Providing information on the credit union’s web site about overdraft protection.

Disclosure of Balance

Guidance

- Available Balance. Credit unions should not include the Overdraft Protection amount in the available balance. The available balance disclosed to the member should be the amount the member can withdraw without overdrawing the account, i.e. the actual balance. The member should receive the same available balance amount no matter what service is being used (e.g., teller inquiry, ATM screen, on-line banking, debit card transaction, or telephone transfer)

ATM Cash Withdrawals

Guidance

- Notice on Credit Union-Owned or -Controlled ATM Screens. Credit Unions should include a notice on their owned or controlled ATMs that the member views prior to completion of a transaction. The notice should explain to the member that completion of the transaction may result in an overdraft and the member may incur an overdraft fee.
- Notice on Other ATM Screens. The Division encourages credit unions to inquire of their ATM service providers as to the availability of additional disclosures regarding overdraft fees on ATM screens.

Opt-Out

Guidance

- Notice of Opt-Out Privilege at Account Set-Up. Members should be informed at the time they qualify for protection that they may opt-out. Members should be informed of the consequences of opting-out, and any alternatives to Overdraft Protection Programs.
- Timing & Methods of Opting-Out. Members should be able to opt-out of the Program at any time by a clearly defined method disclosed in the deposit contract.

Notification of Overdrafts

Guidance

- Universal Notification. Credit Unions should send written notification to the member within one to two business days of payment of an item causing an overdraft.
- Contents of Notification. Written notification should include the following: amount of overdraft(s), date of overdraft(s), associated fees, required amount to be repaid, required time of repayment, and a number to call, or a website or e-mail address to contact if the member has questions.
- Follow-up Letters. Credit unions should send one or more follow-up letters when the account remains overdrawn. The notice should contain the date by which the overdraft amount must be repaid to remain eligible for the Overdraft Protection Program.

Best Practice

Contact by Phone. The member is contacted by telephone the same day the overdraft occurs.

Amount & Disclosure of Overdraft Fees

Guidance

- Additional Charges/Interest. These charges include daily interest or periodic fees exceeding what a credit union imposes as an overdraft protection fee. [For example, charging \$3 per day when the member has a negative balance, or charging interest after 3 business days at prime rate plus two percent.] Currently, federal regulators are reviewing whether or not such fees are finance charges and subject to disclosure under Regulation Z, 12 CFR, section 226.4(b)(2). As a result of these concerns, the Division cautions credit unions not to impose additional charges/interest over and above their Overdraft Protection Program fee.
- Overdraft Protection Program Fees in Excess of NSF Fees. Overdraft protection fees exceeding the amount of NSF fees may trigger finance charge disclosure requirements contained in Regulation Z, 12 CFR, section 226.4(b)(2). As a result of these concerns, the Division cautions credit unions not to impose overdraft protection fees in excess of NSF fees.
- Truth in Savings Disclosures. All overdraft protection fees and charges in connection with a deposit account must be disclosed in order to be in compliance with the Truth in Savings Act and Regulation DD (12 USC, section 4301 et seq. and 12 CFR, part 230.1). [Note: If the service is to be implemented after account opening, the notice of fees, if given at a later time, must meet all applicable notice of change requirements under such regulations.]

“Dollar Limits” of Overdraft Protection Program

Guidance

- Consistent Requirements. The amount of protection should be based on a consistent and standard set of factors.

- Increasing Limits Based on Account Behavior. Credit unions should place reasonable initial dollar limits per account. Increases in the dollar limits should be approved based on the member's ability to handle the increased limit, an analysis of account activity, and an analysis of risk. Institutions should not raise the limits for the primary purpose of increasing the volume of NSF's per customer account.

Pay/No Pay Decisions

Guidance

- Consistent Objective Methods for Honoring Overdrafts. Credit unions should have consistent objective methods for their Overdraft Protection approval process, whether automated or having personnel review the transactions.
- No Change in Order. Credit unions should not change the order in which items are honored for the purpose of increasing the number of items that would overdraw an account.
- Disclosure. Credit unions should clearly disclose to their customers the order in which items will be paid.

Suspension of Overdraft Protection

Guidance

- Disclosure of Grounds for Suspension. Reasons for suspension/cancellation of Overdraft Protection should be clearly disclosed to the member. Such reasons may include: failing to bring accounts to a positive balance within xx days; filing for bankruptcy protection; delinquency of a loan account; or illegal activity such as check kiting.
- Notification of Suspension. Members should be notified in writing when protection is suspended/cancelled.
- Consistent Application of Suspension Rules. Rules for suspension/cancellation of Overdraft Protection should be applied consistently based on specific, identified criteria.

Best Practices

After an account has been overdrawn for five consecutive days: a letter is mailed instructing the member to immediately bring the account to good standing. If the account is not brought to good standing within the next five days, transactions on the account will not be honored (because the Overdraft Limit will be suspended). After ten consecutive days, another letter is sent instructing the member to immediately bring his or her account to good standing. This letter also notifies the member that transactions on the account will not be honored (because the Overdraft Limit has been suspended). Once Overdraft Limit is suspended, it no longer appears on the periodic statement.

Third Party Vendors

Guidance

- Third-Party Risk. The Office of the Comptroller of the Currency (OCC) has previously issued guidance as to risks in dealing with a third-party vendor of Overdraft Protection, which the Division, in principle, endorses.
- No Third-Party Sharing of Risk/Due Diligence of Vendor. Some arrangements that a credit union enters into with a vendor to participate in an Overdraft Protection Program is devised in such a manner that only the credit union is subject to the credit and reputation risk, while the vendor shares the benefits (i.e., the income). Credit unions should conduct due diligence reviews of vendors. This includes initial and ongoing reviews of the financial information of any vendor. These reviews are necessary to ensure that the vendor can fulfill the representations as outlined in the contract. Requirements for the timing and quality of financial information should be set forth in the vendor's contract.
- Lock-In (Anti-Termination) Clauses. Beware of contracts with a termination clause that prohibits or severely restricts the contracting credit union's ability to terminate once a Program is initiated.